

ANALYSIS OF ORIGINAL BILL

Author: Karnette Analyst: Jeani Brent Bill Number: SB 1814

Related Bills: See Legislative History Telephone: 845-3410 Introduced Date: 02/18/98

Attorney: Doug Bramhall Sponsor:

SUBJECT: Enterprise Zone/Remove Employee Limitation For Long Beach Enterprise Zone Hiring Credit

SUMMARY

This bill would modify the definition of "qualified wages" for the Long Beach Enterprise Zone hiring credit by removing the current 1,350-person limitation on the number of qualified aircraft manufacturing employees for which an enhanced hiring credit may be taken so that an unlimited number of employees would be eligible for computation of the credit.

EFFECTIVE DATE

This bill would apply to taxable or income years beginning on or after January 1, 1998.

LEGISLATIVE HISTORY

AB 69, AB 82, AB 797 (Stats. 1997, Ch. 461), AB 1217 (Stats. 1997, Ch. 602), SB 200 (Stats. 1997, Ch. 609), SB 635, SB 965 (Stats. 1997, Ch. 603); AB 2456 (1996), AB 296 (Stats. 1996, Ch. 953), SB 38 (Stats. 1996, Ch. 954) SB 715 (Stats. 1996, Ch. 952), SB 2023 (Stats. 1996, Ch. 955); SB 712 (Stats. 1995, Ch. 494); AB 2206 (Stats. 1994, Ch. 853), SB 1438 (Stats. 1994, Ch. 754), SB 1770 (Stats. 1994, Ch. 755).

PROGRAM HISTORY/BACKGROUND

California has five types of economic development areas that have similar tax incentives:

- Enterprise Zones,
- Los Angeles Revitalization Zone (LARZ),
- Local Agency Military Base Recovery Areas (LAMBRA),
- Targeted Tax Area (TTA), and
- Manufacturing Enhancement Area (MEA)

DEPARTMENTS THAT MAY BE AFFECTED:

____ STATE MANDATE

____ GOVERNOR'S APPOINTMENT

Board Position:

____ S ____ O
____ SA ____ OUA
____ N ____ NP
____ NA ____ NAR
____ X ____ PENDING

Agency Secretary Position:

____ S ____ O
____ SA ____ OUA
____ N ____ NP
____ NA ____ NAR
DEFER TO _____

GOVERNOR'S OFFICE USE

Position Approved ____
Position Disapproved ____
Position Noted ____

Department Director

Gerald H. Goldberg

3/9/98

Agency Secretary

Date

By:

Date:

The following table shows the incentives available to each of the economic development areas.

| Types of Incentives | EZ | LARZ* | LAMBRA | TTA | MEA |
|----------------------------|----|-------|--------|-----|-----|
| Sales or Use Tax Credit | X | X | X | X | |
| Hiring Credit | X | X | X | X | X |
| Construction Hiring Credit | | X | | | |
| Employee Wage Credit | X | | | | |
| Business Expense Deduction | X | X | X | X | |
| Net Interest Deduction | X | X | | | |
| Net Operating Loss | X | X | X | X | |

* NOTE: the LARZ expires December 1, 1998.

SPECIFIC FINDINGS

Under the Government Code, existing state law allows the governing body of a city or county to apply for designation as an enterprise zone. Using specified criteria, Trade and Commerce Agency (TCA) designates enterprise zones from the applications received from the governing bodies. Enterprise zones are designated for 15 years and TCA has designated each of the 39 enterprise zones authorized under existing law.

Under the Revenue and Taxation Code, existing state law provides special tax incentives for taxpayers conducting business activities within enterprise zones. These incentives include a sales or use tax credit, hiring credit, business expense deduction, and special net operating loss treatment. Two additional incentives include net interest deduction for businesses that make loans to businesses within an enterprise zone and a tax credit for employees working in an enterprise zone. See Attachment A for a detailed discussion of each incentive.

Existing state law allows a hiring credit to enterprise zone employers for wages paid to specific individuals. A credit is allowed for the taxable or income year equal to the sum of each of the following qualified wages paid to a qualified employee.

Qualified wages are defined as (1) the portion of wages that does not exceed 150% of the minimum wage, (2) wages received during the five-year period beginning when the employee commences employment with the taxpayer, (3) wages paid before the expiration of the enterprise zone designation or within 60 months after the designation expiration.

In addition, **existing state law** provides that the maximum amount of certain qualified wages eligible for the hiring credit is 202% of the minimum wage for up to 1,350 qualified employees employed by the taxpayer in the Long Beach Enterprise Zone in aircraft manufacturing activities described in Codes 3721 to 3728, inclusive, and 3812 of the Standard Industrial Classification (SIC) Manual.

SB 1814 would modify the definition of "qualified wages" for the Long Beach Enterprise Zone hiring credit by providing that the limitation of wages up to 202% of the minimum wage applies to all employees of that enterprise zone employed in aircraft manufacturing activities, instead of the existing limitation of up to 1,350 employees.

Implementation Considerations

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

FISCAL IMPACT

Departmental Costs

This bill would not significantly impact the department's costs.

Tax Revenue Estimate

The revenue loss from this bill is estimated to be approximately \$1million annually for every 500 employees who qualify.

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue Estimate Discussion

Revenue losses under the Personal Income Tax Law and the Bank and Corporation Tax Law would depend on the amount of wages paid to qualifying employees, and the state tax liabilities of employers claiming additional tax credits.

It is estimated as a rule of thumb that for every 500 additional enterprise zone employees qualifying employers for the higher credit of 202% of minimum wage per hour (as of March 1, 1998, the minimum wage is \$5.75 per hour), the additional credit would result in revenue losses of \$1 million annually.

BOARD POSITION

Pending.

SENATE BILL 1814 (Karnette)
INTRODUCED FEBRUARY 18, 1998
Attachment A

ENTERPRISE ZONE TAX INCENTIVES

Sales or Use Tax Credit

The sales or use tax credit is allowed for an amount equal to the sales or use taxes paid on the purchase of qualified machinery purchased for exclusive use in an enterprise zone. The amount of the credit is limited to the tax attributable to enterprise zone income. Qualified property is defined as machinery and machinery parts used to:

- manufacture, process, combine, or otherwise fabricate a product;
- produce renewable energy resources; or
- control air or water pollution.

In addition, qualified property must be purchased and placed in service before the enterprise zone designation expires. The maximum value of property that may be eligible for the enterprise zone sales or use tax credit is \$1million for individuals and \$20 million for corporations.

Hiring Credit

A business located in an enterprise zone may reduce tax by a percentage of wages paid to qualified employees. A qualified employee must be hired after the area is designated as an enterprise zone and meet certain other criteria. At least 90% of the qualified employee's work must be directly related to a trade or business located in the enterprise zone and at least 50% must be performed inside the enterprise zone.

The total amount of the credit is the sum of each the following:

- 50% of the wages paid in the first year of employment;
- 40% of the wages paid in the second year of employment;
- 30% of the wages paid in the third year of employment;
- 20% of the wages paid in the fourth year of employment;
- 10% of the wages paid in the fifth year of employment.

The credit generally is based on the lesser of the actual hourly wage paid or 150% of the current minimum hourly wage (for certain Long Beach Enterprise Zone employees, the maximum is 202% of the minimum wage). The amount of the credit must be reduced by any other federal or state jobs tax credits and the taxpayer's deduction for ordinary and necessary trade or business expenses must be reduced by the amount of the hiring credit. Certain criteria regarding who may be qualified employees and certain limitations differ between the various enterprise zone.

Business Expense Deduction

A business located in an enterprise zone may elect to deduct as a business expense a specified amount of the cost of qualified property purchased for exclusive use in the enterprise zone. The deduction is allowed in the taxable or

income year in which the taxpayer places the qualified property in service. The property's basis must be reduced by the amount of the deduction. For enterprise zones, the maximum deduction for all qualified property is the lesser of 40% of the cost, or the following:

If the property was placed in service:

| Months after designation | Maximum deduction Enterprise Zones |
|--------------------------|------------------------------------|
| 0 to 24 | \$40,000 |
| 25 to 48 | 30,000 |
| 48 and over | 20,000 |

Net Operating Loss Deduction

A business located in an enterprise zone may elect to carry over 100% of the enterprise zone net operating losses (NOLs) to deduct from enterprise zone income of future years. The election must be made on the original return for the year of the loss. The NOL carryover is determined by computing the business loss that results from business activity in the enterprise zone.

Net Interest Deduction

A deduction from income is allowed for the amount of net interest earned on loans made to a trade or business located in an enterprise zone. Net interest is defined as the full amount of the interest less any direct expenses (e.g., commission paid) incurred in making the loan. The loan must be used solely for business activities within the enterprise zone and the lender may not have equity or other ownership interest in the enterprise zone trade or business.

Employee Wage Credit

Certain disadvantaged individuals are allowed a credit for wages received from an enterprise zone business. Public employees are not eligible for the credit. The amount of the credit is 5% of "qualified wages," defined as wages subject to federal unemployment insurance. For each dollar of income received by the taxpayer in excess of qualified wages, the credit is reduced by nine cents. The credit is not refundable and cannot be carried forward. The amount of the credit is limited to the amount of tax that would be imposed on income from employment in the enterprise zone, computed as though that income represented the taxpayer's entire taxable income.

Apportioning

For businesses operating inside and outside an enterprise zone, the amount of credit or net operating loss deduction that may be claimed is limited by the amount of tax or income attributable to the enterprise zone. For businesses operating in an enterprise zone, the apportionment formula is the same as that used by all businesses that operate inside and outside the state, which includes a property factor, a payroll factor, and a double-weighted sales factor.